State of California

Board of Equalization
Legal Division-MIC: 82

M e m o r a n d u m

325.0192

To : Mr. Joseph D. Young
Acting Headquarters Operations Manager (MIC:49)

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Subject: A--- P--- L---, Ltd.
SR S – XX-XXXXXX

The Appeals Section issued a Decision and Recommendation January 28, 20XX in the above-cited matter concluding that petitioner's use of the subject generator sets (generators) qualified for exemption. You ask whether this conclusion is correct. It is not.

The basis for Appeal's conclusion was the assumption that petitioner's use of the generators met all requirements of subdivision (b)(1)(B) of Regulation 1620 (this reference should actually should have been to subdivision (b)(2)(B)1 of Regulation 1620). The facts stated in the Decision and Recommendation itself contradict this assumption. Instead, the record as reflected in the Decision and Recommendation establishes that petitioner in fact first functionally used the generators in California. The use of the generators therefore cannot qualify for the claimed exemption.

DISCUSSION

The facts here are not in dispute. Petitioner purchased generators which were delivered to it at ---, California. It was at that California location where the generators were first used, after being temporarily attached to intermodal cargo containers that had been transported to California from outside the state. The Appeals Section concluded that the generators became components of the intermodal cargo containers even though they were attached on a temporary basis. However, even given this conclusion, the January 28, 2002 Decision and Recommendation failed to take into account that the generators could not have become components of the intermodal cargo containers until they were first temporarily attached to the intermodal cargo containers, and that occurred *in California*. Thus, the generators (though not the intermodal cargo containers) were first functionally used in this state after their temporary attachment to the intermodal cargo containers. Accordingly, the use of the generators cannot

qualify for exemption under subdivision (b)(2)(B)2. of Regulation 1620 even though the use of the intermodal cargo containers themselves qualified based on that provision's alternative method of showing that they were first functionally used outside California.

It is logical that a part attached to other property such that it becomes a component of the property cannot have been used as a component of that property until actually attached as such. For this reason, it has long been the rule that when property is attached to become a component of other property, the use of which may qualify for exemption, the use of the component part is examined as of the date it is attached to become a component without regard to the application of tax to the use of the property to which it is attached.

BTLG Annotation 105.0018 (6/19/95) explains this rule as applied to the purchase of parts becoming components of an aircraft used as a common carrier, the taxpayer contending that the use of the parts also qualified as use of a common carrier aircraft.[1] If the parts are installed on the aircraft outside California so that the parts first enter California as component parts of the aircraft, then the parts themselves are treated as aircraft for purposes of the exemption because when California jurisdiction attached, the parts were in fact component parts of the aircraft (and thus must themselves be considered aircraft). The annotation explains that "when aircraft parts are installed onto aircraft outside California and first enter this state as part of the aircraft, the parts themselves are regarded as 'aircraft' for purposes of section 6366.1." The annotation then goes on to explain that the test period for determining if the use *of the component parts* (as opposed to the rest of the aircraft) qualifies for exemption under section 6366.1 is based *on the first entry into California of the component parts of the aircraft* (not based on the first entry of the rest of the aircraft):

> "The test period for any part in question is the twelve-month period following that part's entry into California. Thus, even if the aircraft qualifies for the common carrier exemption, that does not mean that the use of the parts automatically qualifies. If the aircraft on which the parts installed is not used principally a common carrier during the twelve months following the part[']s first entry into this state, use tax applies to the use of that part in California."

BTLG Annotation 325.0002.200 (7/09/96) applies this same concept to the installation of parts onto an aircraft when the issue is whether the aircraft and the component parts had been purchased for use in California. Regulation 1620 provides a presumption that property used more than 90 days outside California prior to its first entry is not regarded as having been purchased for use in California. Annotation 325.0002.200 applies this test period when an

[1] After this annotation was published, the Legislature amended Revenue and Taxation Code section 6366 to provide an exemption for the sale and use of parts becoming components of an aircraft used as a common carrier. Thus, the purchase and use of parts can now, independently, qualify for exemption under section 6366. Accordingly, this analysis is not required if the claim is that the use of the parts comes within section 6366. On the other hand, where, as here, the claim of exemption is based on Regulation 1620, this same analysis remains applicable.

aircraft is used for awhile outside California, and then is modified outside California to incorporate additional parts, and then brought into this state:

> "The test applicable to the modifications is separate from the aircraft. That is, if the aircraft is used outside California for 100 days prior to its first entry into California, use tax will not apply to its use in California. If the modifications are performed after 50 days of use outside of California, and then the aircraft, with those modifications, enters California 50 days later, the modification will be presumed to have been purchased for use in California, since the modified aircraft would have entered within 90 days of purchase, even though the aircraft will not be regarded as having been purchased for use in this state. Thus, use tax would apply to the purchase price of the modification unless the modification (i.e., the modified aircraft) is used or stored outside of California one-half or more of the time during the six-month period immediately following the first entry of the modification in California.
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> "If the aircraft does not enter California within 90 days of the purchase (and first functional use) of the modification, excluding time of shipment and time of storage for shipment to California, California Use Tax will not apply to either the purchase of the aircraft or the purchase of the modification."

In addition, BTLG Annotation 325.0100.500 (8/30/96) applies this same concept to the use of component parts of rail freight cars, explaining that the parts are regarded as rail freight cars upon their entry into California if at that time that are actually component parts of the rail freight cars, but if they are installed onto the rail freight cars in California, they are not rail freight cars qualifying for the rail freight car exemption of Revenue and Taxation Code section 6368.5.

Petitioner's claim of exemption is based on subdivision (b)(2)(B)2. which is specifically applicable to the use of intermodal cargo container as defined therein and provides that the use of such containers is exempt from tax if satisfying the requirements of subdivision (b)(2)(B)1. of Regulation 1620. Under subdivision (b)(2)(B)1., the use of property is exempt from use tax if it is "purchased for use and used in interstate or foreign commerce prior to its entry into this state, and thereafter used continuously in interstate or foreign commerce both within and without California and not exclusively in California." In other words, if the property is first functionally used in this state, its use cannot qualify for this exemption and use tax applies. (Reg. 1620(b)(3) ("property purchased outside of California which is brought into California is regarded as having been purchased for use in this state if the first functional use of the property is in California").)

The first sentence of subdivision (b)(2)((B)2. defines "intermodal cargo containers." The second and third sentence restate and apply the general rules for the interstate commerce exemption to the use of intermodal cargo containers (i.e., the second and third sentences simply restate the rules as they existed before the amendment to the regulation). It is only the fourth

sentence that added anything new. That sentence added an alternative method of establishing that an intermodal cargo container was first functionally used in interstate or foreign commerce prior to its entry into California when satisfying all of the following conditions:

> "a. The contract for the sale or lease of the intermodal cargo container requires that the container be used in interstate or foreign commerce and such sales contract or lease contract is entered into prior to the entry of the intermodal cargo container into California;
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> "b. The purchaser or lessee transports the intermodal cargo container into California with the specific intent that such intermodal cargo container will then be loaded with freight for transport in a continuous movement to a destination outside California, whether or not the purchaser knows which particular freight will be loaded into the intermodal cargo container at the time the intermodal cargo container first enters California; and
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> "c. The intermodal cargo container is, in fact, first loaded with freight for transport in a continuous movement to a destination outside California, and the intermodal cargo container is thereafter used continuously in interstate or foreign commerce both within and without California and not exclusively in California."

It is obvious, based on the facts stated in the Decision and Recommendation, that these provisions explaining when an intermodal cargo container will be regarded as first functionally used outside this state cannot apply in the present case. A generator cannot itself be regarded as an intermodal cargo container until it is physically attached to the intermodal cargo container to become a component part thereof: here, that did not happen outside California. Thus, the generators cannot be regarded as first used as intermodal cargo containers outside the state. They were attached inside California, and were then first used inside California. Without regard to whether that first use of the generator is regarded as a use of the generator as such, or the use of the generator as a component part of the intermodal cargo container, the first use of the generators occurred in California. Thus, the use of the generators cannot qualify as exempt use in interstate commerce since the generator were first functionally used in this state. (Reg. 1620(b)(3).)

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